

Reference copies to District

Date Nov. 6, 1990

Surname [REDACTED]

OP:E:EO:T:4

SEP 4 1998

Employer Identification Number: [REDACTED]

Key District: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax as an organization described in section 501(c)(7) of the Internal Revenue Code. For the reasons stated below, we conclude that you do not qualify for tax exemption under this section. Your protest rights are also explained below.

You were incorporated under the nonprofit statute of [REDACTED] your incorporating instrument sets forth your purposes in [REDACTED]

[REDACTED] states that you are formed to "provide for the recreational enjoyment of the lineal descendants and heirs of [REDACTED] and of the so-called [REDACTED] (the [REDACTED]), all owning property as of [REDACTED] within the area of approximately [REDACTED] surrounding a body of water known as [REDACTED], located in [REDACTED] (the 'Lake'),...through the maintenance and management of the Lake, and to provide for and enhance the fraternal benefits to be derived from the common association of the members of [REDACTED] and of [REDACTED] at the Lake."

Paragraphs [REDACTED] as follows:

[REDACTED] To provide for the development of a harmonious working relationship among all property owners along and close to the Lake shore.

[REDACTED] To help to preserve the Lake in its natural condition by protecting it from over-use and to establish a property conservation plan, including provisions for such measures as access facilities, boating restrictions,

[REDACTED]

dock restrictions, etc.

[REDACTED] To provide measures for liability protection and to safeguard the physical environment by establishing and enforcing controls on the use of the Lake and the Land.

[REDACTED] deals with the stock basis of your corporation and the differences in rights between holders of [REDACTED] and [REDACTED]. You are authorized to issue a total of [REDACTED] shares. An [REDACTED] is one who has acquired certain "Rights" as defined in your By-laws and has registered these Rights respecting a particular parcel of land with your Land Use Committee. Further, the [REDACTED] joins in the "Restrictive Covenants" and agrees to observe the Lake Use Regulations set forth therein. An [REDACTED] has not satisfied these requirements. Voting is reserved to holders of [REDACTED] except for matters involving five specified transactions. Each [REDACTED] is limited to one vote on any matter submitted to a vote regardless of the number of [REDACTED] held.

Bylaws, [REDACTED] deals with Lake Use Rights. Paragraph 1 states that access to the Lake is restricted to holders of Lake Use Rights and their guests. These rights are described separately in a document entitled "[REDACTED]" ([REDACTED]). Further, they are controlled by a document entitled "Restrictive Covenants" ([REDACTED]).

[REDACTED] provides that there are two (2) categories of Rights: Full Rights and Dedicated/Limited Rights. Once activated, Rights in either of these categories have exactly the same privileges and obligations. Under [REDACTED], each Right entitles its owner to a share in the Association.

[REDACTED] provides that the use of the Lake from any lot for any purpose or by any means shall be preceded by the registration of an active Right for that lot with the Land Use Committee. Once so registered, an active Right may not be used to facilitate the use of the Lake from any additional structures or the use of any additional lot(s).

[REDACTED] provides that [REDACTED] shall provide two (2) points of access to the Lake, with appropriate facilities and amenities, one [REDACTED], if and when needed, and the other on [REDACTED] Lake. These access areas shall be reserved for the use of [REDACTED] property owners (and their guests). They may be

owned and managed by [REDACTED], and/or developed cooperatively with [REDACTED] or [REDACTED].

[REDACTED] provides that the area surrounding and including a certain outlet stream shall be preserved as a natural area. The primary objectives shall be to maintain the free and uninterrupted flow of the outlet stream and to insure that the level of the Lake is not adversely affected by natural or artificial means. [REDACTED] also provides that a certain lot shall be held and maintained by the [REDACTED] until such time that it may be used for a community sewage disposal system to serve any of the homes within [REDACTED] community.

[REDACTED] provides that a [REDACTED], consisting of any amount remaining from the proceeds of the sale of [REDACTED] after the payment of all expenses directly connected with the creation of the [REDACTED], shall be established. It shall be invested and administered by you and its income may be used for maintenance and improvement of the Lake, including your administrative and management expenses. [REDACTED] may be used for such capital improvements and major repairs as dredging the Lake, building retaining walls, and putting lime in the Lake. Proceeds from the sale of any [REDACTED] assigned to the [REDACTED] shall be deposited in the [REDACTED].

[REDACTED], and filed with [REDACTED] on [REDACTED], identifies the following parties: [REDACTED]; [REDACTED]; [REDACTED]; and [REDACTED]. The document then sets forth the following objectives:

The several parties hereto are entering into this Agreement and Declaration (hereinafter sometimes the "[REDACTED]") in order: (1) to preserve in its natural condition, [REDACTED], a body of water consisting of approximately [REDACTED] acres (the "Lake"), located in [REDACTED], [REDACTED], [REDACTED], by protecting the Lake from over-use; (2) to provide for the recreational use and enjoyment of the Lake by [REDACTED], and their respective heirs and assigns, as well as certain other parties, through the establishment of comprehensive regulations; (3) to ensure the orderly use, development, and

[REDACTED]

disposition of the properties that the parties hereto own adjoining or in the vicinity of the Lake; (4) to confirm that [REDACTED] has been formed to assist in carrying out these purposes, to take title to the Lake and certain adjoining lands, and to enhance a harmonious working relationship among [REDACTED], and their respective heirs and assigns; and (5) generally to promote the preservation of the Lake as a recreational asset for the long-term use, benefit, and enjoyment of the several parties hereto and their respective successors-in-interest.

Under [REDACTED], all building structures are to be set back a minimum of [REDACTED] feet from the Lake shore. Buildings on lots shall be restricted to single family private dwellings and any structure normally associated with such a dwelling, [REDACTED]. Only [REDACTED] per lakeshore parcel is permitted.

Under [REDACTED], no commercial activity of any nature (other than rentals for residential purposes) will be permitted, with the exception of [REDACTED].

[REDACTED] states that the maximum number of [REDACTED] and [REDACTED], divided into the categories of [REDACTED] and [REDACTED], and are allocated as follows:

[REDACTED] have been allocated, at no cost to the following individuals, as indicated in the table below:

Name(s) of Owner(s)	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]

The document states that, "These Rights are dedicated to, and limited for use with, the land upon which their allocation is based, and they can be sold, conveyed, used or otherwise transferred only with all or a portion of the land to which they were originally dedicated, all as described in [REDACTED]... . Once activated, a [REDACTED] becomes a [REDACTED] [REDACTED]... ."

_____ provides that the development or improvement of any lot for any purpose or the use of the Lake by the owner of any lot requires the registration of _____

In a letter dated _____, you responded to a development letter from our _____ office. In Response _____ you state that "much of the _____ land surrounding the lake was until recently held as tenants-in-common. All of that _____ land was distributed to individuals. We referred in our original answer to _____ by saying that the _____ as created in the _____ was formed and it has been proceeding to complete their assigned tasks pursuant to _____: it has hired professionals to carry out the tasks required to obtain approvals and permits from the governmental authorities having jurisdiction with respect to subdivision and site plan."

You also stated in _____ that the appropriate governmental approvals and permits have been received. The distribution of _____ land has been made. The transfer of title to the Lake from _____ is in process. The distribution of the shares of the _____ has yet to be accomplished.

In _____ you described the Association's social and recreational activities as follows:

_____ is a pristine, natural glacial lake. Homeowners and their families live in close proximity to each other and _____. Membership in the Association, through acceptance of _____ sets a standard for handling common living concerns. Maintenance and preservation of _____ by the Association permits all the property owners to enjoy the benefits of life in, on, and near the Lake. Members enjoy social fellowship together while engaging in fishing, boating and swimming in and on _____, as well as hiking around it.

Section 501(c)(7) of the Code provides for the exemption of clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

Section 1.501(c)(7)-1(a) of the Income Tax Regulations essentially repeats the language of Code section 501(c)(7) but also states that, in general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities.

Section 1.501(c)(7)-1(b) of the regulations provides that a club which engages in business, such as making its social and recreational facilities available to the general public or by selling real estate, timber, or other products, is not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, and is not tax exempt. Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes.

Rev. Rul. 58-589, 1958-2 C.B. 266 discusses the various criteria for recognition of exemption under section 501(c)(7) of the Code. In order to establish that a club is organized and operated for pleasure, recreation, and other nonprofitable purposes, "there must be an established membership of individuals, personal contacts and fellowship. A commingling of the members must play a material part in the life of the organization."

Rev. Rul. 68-168-1 C.B. 269 describes a nonprofit organization formed to develop a lake and adjacent areas in order to provide facilities for the pleasure and recreation of its members. Membership is open to all persons in the community. Upon formation, the organization acquired substantial acreage and after developing recreational facilities on a portion thereof, subdivided the remaining land into building lots which it leases to members for ninety-nine years. Application for membership and choice of lot are embodied in a single form and each member must lease at least one lot. The leased lots may be used for summer cabins or permanent residences, or left vacant. When a lease is executed, the member pays the organization an amount based on the lot value and thereafter pays a nominal annual rental. The organization derives most of its income from the initial payments and annual rentals. Its expenditures are for acquiring, improving, and maintaining its properties.

Rev. Rul. 68-168 cites Code section 501(c)(7) and section 1.501(c)(7)-1(a) of the regulations to the effect that a club otherwise entitled to exemption will not be disqualified because

it raises revenues from members through the use of club facilities or in connection with club activities. Section 1.501(c)(7)-1(b) provides that a club which engages in business, such as selling real estate, is not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes and is not tax exempt.

Rev. Rul. 68-168 then reasons that, "the subdividing and leasing of lots in the manner described constitutes engaging in business. Although the revenues from this activity are derived from the organization's members only, the revenues are not raised from the members' use of recreational facilities, or in connection with the organization's recreational activities. The conduct of such real estate activity...is not incidental to or in furtherance of any purpose covered by section 501(c)(7) of the Code."

Held, the above organization does not qualify for exemption under section 501(c)(7) of the Code.

In Rev. Rul. 75-494, 1975-2 C.B. 214, the Service responds to inquiries as to whether certain activities engaged in by clubs similar to the club described in Rev. Rul. 69-281, 1969-1 C.B. 155 will preclude tax exempt status under section 501(c)(7) of the Code.

Rev. Rul. 69-281 holds that a club whose membership is limited to homeowners in a housing development and that provides recreational facilities that afford opportunities for fellowship and social commingling is tax exempt under section 501(c)(7) of the Code. Although the club was incorporated by a housing developer, it is not controlled by him nor operated as a commercial venture for his benefit.

In Answer #2, Rev. Rul. 75-494 states that a club which administers and enforces covenants for the preservation of the architecture and appearance of a housing development is not operated exclusively for pleasure, recreation, and other nonprofitable purposes as required by section 501(c)(7).

With respect to your own application under Code section 501(c)(7), the evidence in the administrative file leads us to conclude that you do not meet the criteria for tax exemption under this section for a number of reasons. Firstly, we are not convinced that the necessary commingling exists between your members. You have no club or dining facilities, nor do you own or operate any recreational or athletic facilities, such as tennis courts or a golf course, at which your members would have the opportunity to make personal contacts and develop social

ties. Thus, you have not established that commingling of your members plays a "material part in the life of the organization", quoting Rev. Rul. 58-589, cited above.

Secondly, the impetus for your creation lies not in the desire to form a social club within the meaning of section 501(c)(7), but rather the need to manage and preserve property resulting from the settlement of a lawsuit involving [REDACTED] and the land surrounding it was originally owned by [REDACTED] as tenants-in-common. Following the settlement, the land was subdivided among [REDACTED] and [REDACTED] (including [REDACTED]). Your assigned role is to enforce certain restrictive covenants relating to the use of the lake and surrounding land, to help preserve the lake in its pristine state, and to take ownership of the lake itself, two access points, and an outlet stream. The focus of your activities and the revenues that you will derive all relate to your role in conserving and managing the lake and surrounding land for the benefit of the individuals owning the [REDACTED], whether they are holders of [REDACTED]. In this context, section 1.501(c)(7)-1(b) of the regulations provides that a club which engages in business, such as selling real estate, is not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes and is not tax exempt. The holding in Rev. Rul. 68-168, discussed above, is also applicable to your own situation. The revenues which you derive are not raised from your members' use of recreational facilities, or in connection with any recreational activities conducted by you or under your auspices. Instead, the real estate activity which you conduct is not in furtherance of any recreational or social purpose within the meaning of section 501(c)(7).

Thirdly, your assigned responsibilities with respect to enforcement of the restrictive covenants described above is clearly analogous to the situation dealt with in Answer #2 of Rev. Rul. 75-494, cited above. A club which engages in such activity is not operated exclusively for pleasure, recreation, and other nonprofitable purposes as required by section 501(c)(7).

Based on the foregoing, we hold that you do not qualify for exemption from federal income tax as an organization described in section 501(c)(7) of the Code. Accordingly, you are required to file federal income tax returns on Form 1041.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your

NO PROTEST RECEIVED

Date Nov. 6, 1990

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Surname [REDACTED]

[REDACTED]

views, with a full explanation of your reasoning. This statement must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You also have a right to a conference in this office after your protest is submitted. If you desire a conference, you must request it when you file your protest statement. If you are to be represented by someone who is not one of your principal officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

If we do not hear from you within 30 days, this ruling will become final and copies of it will be forwarded to our Cincinnati District Office, wherein exempt organizations determinations have been centralized. Thereafter, any questions about your federal income tax status or the filing of tax returns should be addressed to the Cincinnati District.

When sending a protest or other correspondence with respect to this case, you will expedite its receipt by using the following address on the envelope:

Internal Revenue Service
1111 Constitution Avenue
Washington, D.C. 20224
Attn: OP:E:EO:T:4, Room 6236

Sincerely,

Gerald V. Sack
Chief, Exempt Organizations
Technical Branch 4

cc: DD, Cincinnati
Attn: EO Group
w/admin. file

[REDACTED]

Code	Initiator	Reviewer	Reviewer	Reviewer	Reviewer	Reviewer	Reviewer
	OP: E:EO:T:4	OP: E:EO:T:4					
Surname	[REDACTED]	[REDACTED]					
Date	9-1-98	9-1-98					